United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

affidavit

75-6065

To be argued by
JOHN S. SIFFERT

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 75-6065

CITY OF NEW YORK,
Plaintiff-Appellant,

—v.—

UNITED STATES OF AMERICA,
Defendant-Appellee.

ON APPEAL FROM JUDGMENT DISMISSING COMPLAINT IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLEE

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CITY OF NEW YORK,
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—v.—

UNITED STATES OF AMERICA,
Defendant-Appellee.

ON APPEAL FROM JUDGMENT DISMISSING COMPLAINT IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLEE

Statement of the Case

Appellee, United States of America, submits this brief in opposition to the appeal by plaintiff-appellant, City of New York, from a judgment of the United States District Court for the Southern District of New York entered on May 16, 1975 (JA 27a)* upon a decision of Hon. John M. Cannella dated May 14, 1975 dismissing the complaint with prejudice and costs. (JA 13a-26a)

* References to JA are to the Joint Appendix.

Issues Presented

1. Did the District Court correctly hold that as a matter of law the City of New York could not claim immunity from the imposition of an excise tax pursuant to § 4261 of the Internal Revenue Code, 26 U.S.C. § 4261, on amounts paid for transportation by City officials traveling on official city business?

2. Does 26 U.S.C. § 4261 validly impose a tax in the nature of a user charge under Congress' power to regulate interstate commerce (U.S. Constitution, Article 1, Section 8, clause 3)?

Facts

For purposes of the motion to dismiss the complaint, the United States of America and the District Court assumed the facts alleged in the complaint to be true. Those facts are relatively simple. The City of New York ("City") alleged that its employees traveled by air while conducting necessary business for the City. Its employees purchased and paid for the air transportation, including the federal excise tax which is imposed on all airline passengers. Allegedly the employees were reimbursed by the City for the cost of the air fare and tax. The tax was paid to the Federal Government in connection with the filing of excise tax returns by each airline.

On July 23, 1972, the City filed a claim for refund of the taxes now in suit. Those taxes purportedly amounted to $80,500 covering the period July 1, 1970 through May 31, 1972. The City alleges that its refund claim (JA 9a) was disallowed on January 14, 1973 by the IRS. This action was timely commenced by the filing of the complaint on April 3, 1974. 26 U.S.C. § 6532(a)(1).

Legislation

The City's obligation to pay the $80,500 in airline excise taxes derives from 26 U.S.C. § 4261, which provides in part that "[t]here is hereby imposed upon the amount paid for taxable transportation (as defined in section 4262) of any person which begins after June 30, 1970, a tax equal to 8 percent of the amount so paid. . . ." It is undisputed by the City that the taxes here imposed were on "taxable transportation" for purposes of 26 U.S.C. § 4261 within the meaning of 26 U.S.C. § 4262, set forth in the margin.*

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* 26 U.S.C. § 4262 provides in part:

(a) *Taxable Transportation; In General.*—For purposes of this part, except as provided in subsection (b), the term "taxable transportation" means—

(1) transportation by air which begins in the United States or in the 225-mile zone and ends in the United States or in the 225-mile zone; and

(2) in the case of transportation by air other than transportation described in paragraph (1), that portion of such transportation which is directly or indirectly from one port or station in the United States to another port or station in the United States, but only if such portion is not a part of uninterrupted international air transportation . . . .

(c) *Definitions.*—For purposes of this section—

(1) *Continental United States.*—The term "continental United States" means the District of Columbia and the States other than Alaska and Hawaii.

(2) *225-Mile-Zone.*—The term "225-mile zone" means that portion of Canada and Mexico which is not more than 225 miles from the nearest point in the continental United States.

(3) *Uninterrupted International Air Transportation.*—The term "uninterrupted international air transportation" means any transportation by air which is not transportation described in subsection (a)(1) and in which—

[Footnote continued on following page]

This action arises by virtue of a Congressional decision to withdraw a *statutory* immunity previously granted to states and cities on amounts paid for taxable transportation. Prior to July 1, 1970 the Congress provided a statutory exemption for state and local governments from payment of Section 4261 taxes:

> "Sec. 4292. *State and Local Government Exemption.*
>
> Under regulations prescribed by the Secretary or his delegate, no tax shall be imposed under section 4251, or 4261 upon any payment received for services or facilities furnished to the Government of any State, territory of the United States, or any political subdivision of the foregoing or the District of Columbia."

Effective July 1, 1970 the Congress deleted reference to section 4261 in the above passage. Airport and Airway Revenue Act of 1970, Title II, Pub. L. 91-258, section 205(a)(2), 84 Stat. 241. Thus, as the District Court found, in amending 26 U.S.C. § 4292 to delete reference to section 4261, the Congress had "completely withdraw[n] from the law the previous statutory grant of immunity accorded to New York City and other political

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> (A) the scheduled interval between (i) the beginning or end of the portion of such transportation which is directly or indirectly from one port or station in the United States to another port or station in the United States and (ii) the end or beginning of the other portion of such transportation is not more than 6 hours, and
>
> (B) the scheduled interval between the beginning of any two segments of the portion of such transportation referred to in subparagraph (A)(i) is not more than 6 hours . . . .

entities [for payment of taxes under 26 U.S.C. § 4261]." (JA 16a-17a).

The intent of Congress to remove the state and local exemptions from payment of section 4261 taxes is plainly evidenced in the history of the Airport and Airway Revenue Act of 1970, Pub. L. 91-258. House Report No. 91-601 of the House Ways and Means Committee, dated October 27, 1969, explained "[t]he principal purpose of this legislation is to provide for the expansion and improvement of the Nation's airport and airway system. In substantial part, this purpose is to be achieved through the imposition and application of airport and airway user charges." 1970 U.S. Code Cong. and Admin. News 3047. The Report continues, "[t]he important point at this time is to maintain, and substantially update and improve the [air transportation] system" without obligating the Federal Government to "long term debt." (*Id.* at 3049, 3048) Finding "[o]ur inability to build an air transportation system of airways and airports at a rate equal to the growth of air transportation demand has manifested itself in the phenomenon of congestion", the Report called for the "formulation and implementation of a national transportation policy." (*Id.* 3051, 3056). An integral part of that national policy was to tax airline users 8 percent of the amount paid for air fare and then to create an airport and airway trust fund with the sums equivalent to those appropriated by the tax. (See section 208 of Pub. L. 91-258; 1970 U.S. Code Cong. and Admin. News 3085.)

Specifically with respect to the then existing exemption to state and local governments from payment of transportation taxes, the House Report states:

> Present law provides a series of exemptions from the tax on transportation of persons by air. These include exemptions: . . . (5) for transportation furnished to the United States (at the discre-

> tion of the Secretary of the Treasury) and to State and local governments . . . .
>
> The Ways and Means Committee has deleted most of these exemptions either as obsolete provisions or as unnecessary complications of existing law . . . .
>
> . . . .
>
> . . . .
>
> The exemptions for transportation furnished to State and local governments, the United States, and nonprofit educational organizations are terminated. . . . It did not seem appropriate to continue special exemptions for these governmental and educational organizations since this tax is now generally viewed as a user charge. In this situation there would appear to be no reason why these governmental and educational organizations should not pay for their share of the use of the airway facilities. Moreover, should these exemptions be retained where now applicable, it would be difficult to see why other equally meritorious nonprofit organizations should not also be granted exemption. (1970 U.S. Code Cong. and Admin. News 3090-91.)

With the removal of the statutory exemption from payment of taxes on air transportation, the City is left to its antiquated and unsound claim that the doctrine of intergovernmental tax immunity entitles the City to a refund of the $80,500 in taxes paid.

ARGUMENT

POINT I

The District Court Correctly Held That as a Matter of Law the City of New York Could Not Claim Immunity From the Imposition of Excise Taxes Under 26 U.S.C. § 4261.

The District Court, in a scholarly opinion, held "[t]he statutory exemption previously enjoyed by the City having been abrogated in 1970, we conclude that the constitutional doctrine of intergovernmental tax immunity will not properly assume its place." (JA 25a) Rather than recite the rationale of Judge Cannella at length in this brief, appellee United States of America respectfully refers this Court to the District Court's opinion (JA 13a-26a) and incorporates its findings herein.

In urging affirmance of the lower court's dismissal of the complaint for failure to state a claim, pursuant to Rule 12(b)(6), F. R. Civ. P., the United States of America will highlight certain aspects of Judge Cannella's opinion.

First, the identical issue raised here has already been decisively resolved in favor of the Government in *State of Texas* v. *United States of America*, 72-2 U.S.T.C. ¶ 16,048 at p. 86,128 (W.D. Tex.), *aff'd per curiam*, 73-1 U.S.T.C. ¶ 16,085 at p. 81,394 (5th Cir. 1972). After reviewing the legislative history, District Judge Roberts concluded that "Nothing in the historical basis of dual sovereignty underlying the principle of state immunity from federal taxation requires that the states continue to receive the benefit of airway facilities and services actually used by the states but furnished by the Federal Government without bearing their equitable share of the

costs incurred in providing those particular benefits." (72-2 U.S.T.C. at p. 86,131) The Fifth Circuit affirmed without opinion.

Second, as Judge Cannella held, the seminal case in the field of local governmental immunity from federal taxation, *New York* v. *United States*, 326 U.S. 572 (1946), disposes of the City's claims. The City here attempts to escape the *New York* v. *United States* holding on the first level by drawing the distinction between proprietary versus governmental functions.* The City misreads *New York* v. *United States*, since under either Justice Frankfurter's test, in which Justice Rutledge concurred, or Justice Stone's test, in which Justices Reed, Murphy and Burton concurred, the simplistic formula of local governmental immunity from taxation of traditionally local governmental functions was relegated to a relic of history. Further, under both tests, the City fails to state a competent claim of immunity to withstand the motion to dismiss.

New York v. *United States* involved a federal excise tax on the sale and bottling of mineral water by the State of New York. Six Justices of the Supreme Court held that New York was not immune from federal taxation, although the Court was unable to render a majority opinion. Mr. Justice Frankfurter, after tracing the doctrine of local governmental immunity from its roots in Chief Justice Marshall's phase "the power to tax is the power to destroy", *McCulloch* v. *Maryland*, 4 Wheat. 315, 431 (1819), noted that "[t]he whole tendency of recent cases reveals a shift in emphasis to that of limitation upon

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* On the second level, the City argues it should be granted leave to amend its complaint to allege with greater specificity its allegation that the tax imposes an undue burden on the exercise of governmental functions. This claim will be dealt with below.

immunity." (325 U.S. at 576-581). Justice Frankfurter found unpalatable the earlier distinction, now propounded by the City in this case, that local governments are immune from taxation where a "governmental function" is involved but that immunity does not apply where the activity is in the nature of a "normally" private enterprise. Instead Justice Frankfurter proposed that so long as the tax is non-discriminatory "the Constitution of the United States does not forbid it merely because its incidence falls also on a State." (*Id.* at 582) Justice Frankfurter concluded by writing "we decide enough when we reject the limitations upon the taxing power of Congress derived from such untenable criteria as 'proprietary' against 'governmental' activities of States, or historically sanctioned activities of governments, or activities conducted merely for profit, and find no restriction upon Congress to include the States in levying a tax exacted equally from private persons on the same subject matter." (*Id.* at 583-84, footnote omitted.)

Mr. Justice Stone, while concurring in the result, did not believe that the "non-discriminatory tax" test sufficiently defined the appropriate limit of Congress' taxing powers. Justice Stone thought it was also necessary to determine "whether such a non-discriminatory tax unduly interferes with the performance of the State's functions of government." (*Id.* at 588) Justice Stone concluded: "It is enough for present purposes that the immunity of the State from federal taxation would, in this case, accomplish a withdrawal from the taxing power of the nation a subject of taxation of a nature which has been traditionally within that power from the beginning." (*Id.*)

The City simply elides the fact that both Justice Frankfurter (*Id.* at 583-84) and Justice Stone (*Id.* at 586) were able to gather a majority of the Court in explicitly rejecting the "governmental" versus "proprietary" functions test here urged by the City.

Moreover, under both Justice Frankfurter's and Justice Stone's tests the City's complaint fails to state a claim. The District Court correctly held under Justice Frankfurter's formulation: "Clearly, the excise tax imposed by § 4261 of the Code is nondiscriminatory in nature." The tax at issue is equally imposed on all purchasers of airline tickets. (JA 24(a)) The lower court was further correct in holding under Justice Stone's formulation: "We cannot perceive any undue interference with the sovereign functions of City government as the result of its being compelled to contribute to the federal tax coffers in this particular instance." (JA 24a)*

The City's belated effort (Point II in Appellant's Brief) to gain a remand to permit it to amend its complaint to allege with specificity the nature of the burden in this case should be rejected for a variety of reasons. First, the tax involved is merely eight percent of the purchase price of airline tickets. As alleged in the complaint the taxes in question amounts in total to only $80,500 in nearly two years. Given the City Budget which for the year 1975-76 exceeds thirteen billion dollars ($13,000,000,000) and for 1970-71 exceeded eight billion dollars ($8,000,000,000) it is indeed impossible to "perceive any undue interference" that the tax may have on the sovereign status of the City of New York. (See JA 24a; Appellant's Brief at 14) Second, the City's application for remand should be rejected because it is evident that it is not the City's activities—such as extradition or conferences in Albany (Appellant's Brief at 14)—which are being taxed, but rather the means chosen to carry them out. Strictly speaking, the tax in question is not a tax upon a state or city activity *per se*. Finally, it is evident that the City's claim of undue burden is a sham.

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* The District Court in footnote 10 took pains to postulate a situation where a nondiscriminatory tax might impose an undue burden, but concluded this was not such a case.

At no point below did the City suggest reargument pursuant to Rule 60(b)(6), F. R. Civ. P. or to vacate the judgment pursuant to Rule 59(e) or seek to amend the complaint pursuant to Rule 15. Indeed, when the United States propounded interrogatories below which sought to elicit "why no alternative mode of transportation was feasible," the City objected "on the ground that whether or not alternative modes of transportation were or were not feasible for the employee travelling by aircraft on official City business, is completely irrelevant and immaterial and has no bearing on whether or not the tax imposed under Internal Revenue Code § 4261 on that air travel is an unconstitutional burden on the City of New York, the only legal issue involved in the instant action." Subsequently, in connection with its motion to dismiss, the United States moved in the alternative to compel the City to respond to its interrogatories. In its motion papers, the United States argued "One of the defenses which the United States intends to use in this litigation is that it is not an undue burden upon the City because other means of transportation could have been used. It is our contention that [the] tax cannot be considered a burden if the taxpayer can avoid paying it without substantial injury. The City knew that an 8% excise tax would be charged on air transportation, but not on alternative modes of transportation." (Government's Memorandum of Law at 21) The City resisted that motion to compel, arguing that the feasibility of alternative modes of transportation is irrelevant to the issue of burden and that "[t]he proliferation of triable issues in this case that would result from the Court's adoption of such an outlandish notion as the one we are dealing with, would be staggering; the evidentiary burden impossible." (City's Memorandum in Opposition at 23)"

Now, in the face of the adverse decision below, the City suggests that with respect to the issue of burden,

"This kind of detail is more properly the subject of interrogatories under Rule 33 of the Federal Rules of Civil Procedure." (Appellant's Brief at 15) The City cannot have it both ways. This Court should reject the application to amend the complaint since the City has failed to follow the procedures prescribed by *Foman* v. *Davis*, 371 U.S. 178 (1962) and *United States* v. *Hougham*, 364 U.S. 310 (1960), *reh. denied*, 364 U.S. 938 (1961); and since the City chose not to pursue its claim in the alternative. (Appellant's Brief at 18). *Troxel Manufacturing Co.* v. *Schwinn Bicycle Co.*, 489 F.2d 968, 971 (6th Cir. 1973), *cert. denied*, 414 U.S. 1008 (1974).

In this regard it is significant to remember that the issue here under Justice Stone's formulation is whether the tax imposed on the use of air transportation by City employees constitutes an *undue* burden. Obviously there is a burden inherent in the requirement that the City pay moneys that it was previously exempted from paying. However, as argued below (Government's Memorandum of Law at 12), and as the District Court found, the burden is neither substantial in terms of the City's overall budget nor unavoidable to the extent that other less expensive modes of transportation are available. The tax is plainly non-discriminatory and it is a subject traditionally within Congress' taxing powers. As the Ninth Circuit wrote in *United States* v. *Washington Toll Bridge Authority*, 307 F.2d 330, 334 (9th Cir. 1962), *cert. denied*, 372 U.S. 911 (1963), involving the predecessor statute to 26 U.S.C. § 4261: "immunity . . . cannot be successfully asserted on an *ad hoc* basis that such activity involves governmental function."

POINT II

The City Is Not Entitled To Refund Since 26 U.S.C. § 4261 Imposes A Tax In The Nature Of A User Charge Under Congress' Power to Regulate Interstate Commerce (U.S. Constitution, Art. 1, Sec. 8, Cl. 3).

The Fifth Circuit has upheld the imposition of 26 U.S.C. § 4261 taxes on amounts paid by State employees for air transportation on the basis of Judge Roberts' decision in *State of Texas* v. *United States*, *supra*. The *State of Texas* Court relied primarily on the finding that 26 U.S.C. § 4261 represents a user charge properly imposed under the Congress' power to regulate interstate commerce. The City's attempt here to distinguish the *State of Texas* case on the ground that Texas had stipulated that the tax represents a user charge hardly supports appellant's case. Rather, it demonstrates the frivolity of the City's claim that it is not a user charge: there is no reason for Texas to have conceded the point if there was anything to it. Moreover, the District Court made a specific finding that the tax was a user charge after reviewing the legislative history, without reliance on the stipulation. (Conclusion of Law No. 6, 72-2 USTC at p. 86,129-30).

The House Report repeatedly refers to the tax as a user charge, both in the passage cited by appellant (Appellant's Brief at 22) and the Court below, to the effect that ". . . this tax is now generally viewed as a user charge" and in an earlier passage, cited above, to the effect that the purpose of expanding and improving the nation's airports "is to be achieved through the imposition and application of airport and airway users charges." (1970 U.S. Code Cong. and Admin. News at 3091; 3047.) The City's suggestion that this Court should not rely on House Committee Reports to glean congressional intent

is disingenuous; for such reports are the primary source for courts to discern legislative intent. Believing the legislative history is irrelevant, the City counsels this Court to look solely at the statutory language where the word "'tax" appears. This rigid, inflexible approach obscures the fact that Congress recognized and expressed the view that 26 U.S.C. § 4261 imposes an eight percent tax on the amount paid for transportation as defined by 26 U.S.C. § 4262 and that such a tax is in the nature of a user charge. Indeed, the funds appropriated by the charge will be directly related to the amount in the Trust Fund established by the Airport and Airway Development Act of 1970. "Under this legislation a better future is promised because a trust fund will be established and there will be a direct relationship between the use of the system and the money generated to meet the needs required by the users." (1970 U.S. Cong. Code of Admin. News 3049) As the House Report further noted: "The Trust Fund is created in order to insure that the air user taxes are expended only for the expansion, improvement and maintenance of the air transportation system." (*Id.* at 3085)

Both the imposition of the user charge and maintenance of the trust fund under the Airport and Airway Development Act of 1970 and the Airport and Airway Revenue Act of 1970 constitute a legitimate exercise of Congress' power to regulate interstate commerce under Article 1, Section 8, Clause 3 of the U.S. Constitution. *Gibbons* v. *Ogden*, 9 Wheat 1 (1824); *Board of Trustees* v. *United States*, 289 U.S. 48 (1933); *State of Texas* v. *United States*, *supra*, 72-3 USTC at p. 86,131. Plainly, the fact that the eight percent excise tax may also fall on passengers flying solely intrastate does not abrogate Congress' power to regulate air transportation or to impose a tax on the use of air transportation facilities. See *Perez* v. *United States*, 402 U.S. 146 (1971); *Katzenbach* v. *McClung*, 379 U.S. 294 (1964); *United States* v. *Darby*,

312 U.S. 100 (1941); *Franchised Stores of New York* v. *Winter*, 394 F.2d 664, 669 (2d Cir. 1968); *Myzel* v. *Fields*, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968).

As the Third Circuit remarked, "The Supreme Court has recognized that the commerce power is less restricted than the federal taxing power, and it has held that the standards developed to define the boundaries of state immunity from federal taxation are inapplicable to federal regulation of state activities under the Commerce Clause." *Commonwealth of Pennsylvania* v. *Environmental Protection Agency*, 500 F.2d 246, 262 (3d Cir. 1974). It is irrelevant that the Congress created a new burden upon the City by removing the tax exemption; for, "when Congress does act [under the commerce clause], it may place new or even enormous fiscal burdens on the States." (*Id.*, citing *Employees of the Department of Public Health and Welfare* v. *Department of Public Health and Welfare*, 411 U.S. 279, 284 (1973).

In sum, under both the taxing and commerce powers, whether 26 U.S.C. § 4261 constitutes a tax or a user charge, "no logical reason exists why all users of the air transportation system should not pay their fair share of [the system's] costs." *State of Texas* v. *United States*, *supra*. The City is no exception.

CONCLUSION

The judgment dismissing the complaint for failure to state a claim with prejudice and costs should be affirmed.

Dated: New York, New York
January 5, 1976

Respectfully submitted,

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County of New York) ss

Pauline P. Troia being duly sworn, deposes and says that she is employed in the Office of the United States Attorney for the Southern District of New York.

That on the 5th day of January 1976 she served a copy of the within govt's brief

by placing the same in a properly postpaid franked envelope addressed:

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Sworn to before me this

5th day of January 1976

Ralph I. Lee

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Notary Public, State of New York
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Term Expires March 30, 1977